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Is Life After the Welfare State Possible?

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ABSTRACT

Recent macroeconomic trends primarily but not exclusively in Europe suggest that the welfare state is not conducive to growth and prosperity. European welfare-state economies have experienced a long-term decline in GDP growth, private consumption and domestic absorption; and a long-term increase in unemployment. Macroeconomic data suggest a correlation between the expansion of the welfare state and the decline in economic growth. Given that the welfare state is antithetical to growth and prosperity, is it possible to reform it away? This paper develops a framework for this question, identifying strict conditions under which welfare-state retrenchment or termination is possible.

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The Problem

The welfare state is probably the largest socio-economic experiment in the free world. Its ideological roots stretch back to the early 19th century, with the development of a full-fledged welfare state in Europe spanning several decades of the mid-20th century. The American welfare state is still half-baked by comparison, though it is still slowly expanding unlike its European peers.

Broadly, Europe’s welfare states followed two traditions: one represented by the Beveridge Report in Britain and one founded on the more radical writings of Swedish economist Gunnar Myrdal and his wife, sociologist Alva Myrdal.

Based on the more conservative nature of the Beveridge-based British welfare state, the Myrdal-based Swedish alternative has come to stand out as the radical alternative. This ambition was put on full display in Sweden where consecutive social-democrat governments developed a welfare state from the first poverty-relief programs to comprehensive, permanent redistribution of income and consumption. It was a concerted effort, the bulk of which took place from the late 1930s through the mid- 1950s. The reforms were aplenty: a single-payer health care system, comprehensive tax-paid child care, centralized K-12 education, mandatory vacation time, a paid-family-leave system and an ambitious social-housing program that removed the profit motive from the bulk of the home construction industry.

Less ambitious welfare states took longer to develop, but the eventual result has been largely the same across Europe. Government provides medical care as well as care for children and the elderly; K-12 schooling and often tertiary education as well; comprehensive income security both during and after workforce participation; workforce training, job-search services and housing.

These entitlement programs are matched with tax systems designed to redistribute the tax income burden from the poor and the middle class to high-income earners and the wealthy. The redistributive effect is clearly visible in evolved welfare states, though varying depending on whether the tax system emphasizes taxes on income, absorption or value added.

Over time the welfare state has set deep economic roots in Europe’s economies. Families have adjusted their living to entitlements, both cash and in-kind, often to a degree where it is no longer possible for them to make ends meet without the welfare state. Taxes have affected workforce participation and business investments, comprehensively changing the economic landscape.

Perhaps the most tangible form of welfare-state presence in modern European economies is in the redistribution of income. Gini-coefficient numbers from 25 EU member states (selected exclusively on the merit of access to adequate data) show that income differences fall substantially as a result of the welfare state. Figure 1 reports percentage reductions in the Gini coefficient, annual averages, for a ten-year period:

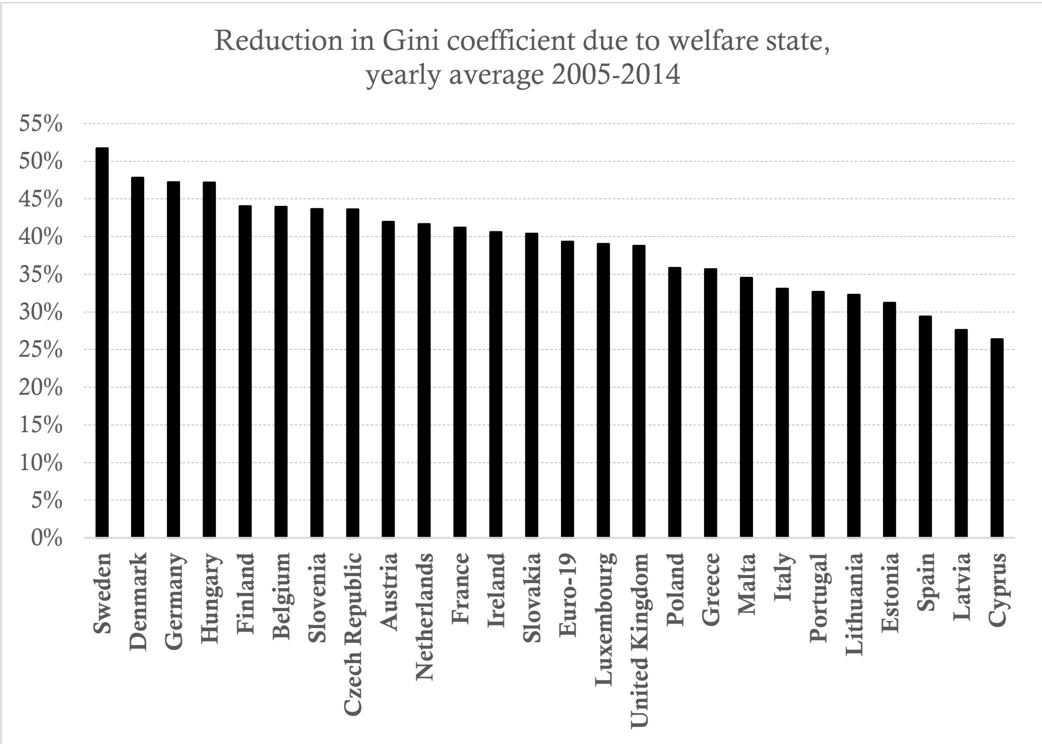

Figure 1
Source: *Eurostat, Social Transfer Data*

Sweden experiences the largest coefficient decline, from 55.0 to 25.4. In other words, for the period 2005-2014 the Swedish Gini coefficient was, on average, 51.7 percent lower thanks to the welfare state.

Put bluntly, these Gini figures show that if the welfare state were to end tomorrow it would plunge large segments of Europe's populations into a standard of living far below what they enjoy today.

At the same time, macroeconomic realities point to the unsustainability of the welfare state. Larson (2014) reports that Europe's economies have been growing slowly and had to deal with high unemployment for up to four decades, a period long enough to correlate with the completion of the welfare state as an institutional structure. Eurostat national-accounts data for the second quarter of 2016 reinforce the impression of a European economy in a macroeconomic quagmire.

The situation is not as bad in the United States, where the welfare state has not yet reached European proportions. However, that does not mean that the American economy has been spared economic stagnation. On the contrary, as University of Chicago economist John Cochrane explained in the Wall Street Journal on May 2, 2016:

"*Sclerotic growth is America's overriding economic problem. From 1950 to 2000, the U.S. economy grew at an average rate of 3.5% annually. Since 2000, it has grown at half that rate—1.76%. Even in the years since the bottom of the great recession in 2009, which should have been a time of fast catch-up growth, the economy has only grown at 2%.*"

Recent Department of Commerce national accounts data suggest the U.S. economy will probably not reach two percent for the full year of 2016.

Given the magnitude of the welfare state's presence in economies on both sides of the Atlantic Ocean it is reasonable to suggest a causal relationship between a nation's macroeconomic performance and the institutional structure of the welfare state. This relationship, in turn, leads to the inevitable question: if it is necessary to dismantle the welfare state in order to restore high growth and full employment, is it at all possible to do so?

Or, more provocatively: is life after the welfare state possible?

The question of the welfare state's presence in the modern industrialized economy is further complicated by the fact that the end goal with the welfare state has never been to strengthen growth and maintain full employment. Those have been intermediate goals, but only instrumental to the end goal, namely the minimization or elimination of economic differences among the citizenry. Since the ideological foundation of the welfare state ignores economic growth, it is therefore impossible to refute it while accepting income redistribution as superior to economic growth.

In other words, while the macroeconomic performance of welfare-state economies generally calls for a serious discussion about the welfare state's future, that discussion cannot be had on the basis of axiomatic acceptance of the welfare state's end goal. The question of economic redistribution would have to be addressed explicitly in relation to the economic performance of welfare-state economies vs. non-welfare state economies – to the extent such economies exist in the industrialized world today.

The Origin of the Welfare State

Changing the discussion about economic redistribution is no small challenge. The redistributive success of the welfare state has earned it broad support from the entire political spectrum. Even politicians whose ideological affiliation should preclude them from supporting the welfare state, have come to accept it over the years. One reason, Kaufmann implies (2012, 278), is that the welfare state has successfully slotted itself between the broad layers of voters and free-market enterprise:

"*The welfare sector's services functionally complement those of the market economy. They depend on the market system's productive abilities, since welfare benefits are chiefly financed from its output through taxes and contributions. However, the [programs of the welfare state] contribute significantly to the productive efficiency of the market economy by improving the creation of human capital, protecting the labour force against premature exhaustion, promoting readiness to work and maintaining or even raising labour productivity*."

There is no denying the success that welfare statists have had in putting their ideology to work. By means of entitlements and taxes, their institutional structure redistributes up to half of GDP in some three dozen developed nations; it institutionalizes and professionalizes charity preferences and creates templates for family life through an elaborate system of economic incentives and disincentives. In a nutshell, the welfare state has socially and economically reorganized life in the most advanced economies in the world.

In order to understand how an ideological project aimed at fundamentally remaking the institutional structure of the free-market economy could be so successful, one has to go back to its point of origin. This proves that the welfare state is not a phenomenon that has emerged haphazardly, but a carefully crafted endeavor, built purposely to either gain universal acceptance from all parts of the political spectrum – or to marginalize those who disagreed with its purpose.

Nowhere is the deliberation behind the welfare state more bluntly spelled out than in Sweden. While there were attempts at creating welfare states already in the 19th century, it is fair to say that its modern origin is to be found in the writings of Swedish economist and Nobel Memorial Prize Laureate Gunnar Myrdal and his wife, sociologist and politician Alva Myrdal.[1] On their long list of scholarly, policy and rhetorical contributions the book *Kris i befolkningsfrågan*,

[1] The professional affiliations of the Myrdals are relevant to their contributions. Kaufmann (2012) erroneously introduces Mrs. Myrdal as an economist (p. 41), but her background in sociology was in fact a perfect professional match for her husband in their efforts to define the foundation, the implementation and the completion of the Swedish welfare-state project. Both of them were involved in all three phases, both academically and politically.

published in 1934, stands out as particularly important.[2] To the best knowledge of this author, this paper is the first introduction of this book to an English-speaking audience; for reasons of convenience in reference, the book will from hereon be referred to as *The Demographic Crisis* (a non-literal English translation).

The book is relevant specifically because it candidly outlines the principles upon which the welfare state shall be built. The fundamental principle, spelled out by the Myrdals, is that there is no upper limit to the expansion of the welfare state. The principal goal with the welfare state, they say, is to minimize and eventually eliminate differences in income and consumption among the citizenry. The pursuit of this goal has no defined end or cap, except the actual complete elimination of economic differences.

This ideological ambition is shared by Sweden's neighbors, meriting the term "the Scandinavian welfare state". It differs from its British counterpart in terms of its end goal. Built largely on the analysis and policy recommendations in the Beveridge Report, the British welfare state sought to create a comprehensive, redistributive safety net for lower-income families. Its goal was never explicitly to eradicate all differences, even though Robinson (1980) points to some expressions of such ambitions in British politics.

In terms of purpose, the differences between the British and the Swedish welfare states have, over time, been diminished by their accomplishments. Today, with more than three decades of stagnation in welfare-state expansion, the remaining differences between the two welfare-state types can probably be attributed to differences in traditions of governance:

- In the Anglosaxian tradition government powers must be balanced against inalienable individual rights, whereupon a natural limitation emerges on the pace of advancement and even the scope of the welfare state;
- The Scandinavian tradition of government does not put any discernible limits on the growth of government; as Huntford (1972) explains, the Swedish welfare state is fully compatible with a tradition where government not only has the *right* but the *responsibility* to govern the affairs of its citizens.

The Myrdals faithfully stick to the latter tradition of government as they lay out the main methodological step toward accomplishing the goals of the welfare state. They define the state's relation to the people using the term "population stock". Their prime instrument for building

[2] Myrdal and Myrdal (1934).

the welfare state is to “transform” this “stock” in the name of the common good. In fact, they do not believe that differences in income and consumption among the citizenry can be eliminated unless government is granted unlimited transformational powers to reconfigure its “population stock” according to what is economically and sociologically needed.

It is easy to relate this reasoning to Malthusianism. In fact, the Myrdals spend a fair amount of time positioning their work in relation to both social radicalism and Neo-Malthusianism. As for the former they explain (p. 8):

“The social radicals cared for the poor and defenseless in society. Toward the end of the 1800s and around the turn of the century they gained a political platform and power base in the growing labor movement, which in turn was significantly influenced by social radical thought; this thought essentially captured the economic interests of the labor movement.“

They also rely on neo-Malthusianism (pp. 8-9) but not in the common fashion. The Myrdals see it as a powerful force for the advancement of economic redistribution, from rich to poor; from capital to labor. However, unlike the neo-Malthusians the Myrdals believe that it is the duty of the government to keep the child-bearing rate in the economy at a sufficiently high level as required to accomplish certain economic goals. Most importantly, they note, the welfare state needs a workforce bred, trained and educated to meet the needs of the productive sector – and produce a large enough tax base to fund all the welfare state’s entitlements.

In addition, demographic planning would be aimed at successfully balancing the need for a growing population stock and a healthy workforce against the poverty risks associated with large families.

Effectively, the core function of the welfare state can be described as *demographic planning*. It consists of a broad range of reforms aimed at changing people’s behavior, to guide their life choices and to bring private preferences in accordance with those of government.

The first instrument for reform is called “prophylactic social policy”. In the opening of chapter seven of *The Demographic Crisis* they explain:

“The direct purpose of the prophylactic social policy is to produce a better human stock. The quality aspect [of the population] rises in importance already because the population is stagnant and then declines at an accelerating rate. So long as the population is growing at high rates the quality aspect is easily reduced to insignificance. At that point it presents itself immediately to view the human stock as merely fuel for industrial production, the use of which does

not have to be guided by frugality, as it is supplied in such abundance; "cannon fodder". However, when the demographic stock responds to its living conditions by ceasing to reproduce itself, one is inclined to carefully address the question to what extent these living conditions could be the result of the quality of the demographic stock itself, and to what extent that stock can be improved upon."

By means of this prophylactic social policy the Myrdals hoped to enhance the "quality" of the population and thereby increase industrial productivity and overall economic growth. That, in turn, would allow government enough resources to comprehensively alter the distribution of income and consumption throughout the economy. The flip side of this is that the welfare state requires strong economic growth to produce adequate tax revenue; strong growth, in turn, requires a highly productive private sector.

Full employment is also critical; unemployment constitutes an enormous waste of productive skills and deteriorates the quality of the workforce (p. 213).

Put plainly, it is of utmost importance for government to have a steadily rising flow of tax revenue to rely on. In order to secure that steady increase, government must "guarantee" steady economic growth; it is a necessary condition for steady economic growth, in turn, that the supply of labor is of the highest possible quality.

In order to manage labor supply government needs to manage the upbringing and education of children. The Myrdals spend an entire chapter on reforms aimed at conforming living conditions for families with young children, always with reference to the overarching ideological goal of the welfare state. They advocate income redistribution to benefit low-income families, arguing that poverty deters parents from having a sufficient number of children. It also bars them from providing properly for their children's upbringing.

In this respect the Myrdals followed a tradition that others have traced all the way back to socialist utopians such as Robert Owen and Charles Fourier of the very earliest days of the 1800s. Swedish historian Yvonne Hirdman (1994) puts the utopians' view instrumental view of children in the context of modern-day Swedish welfare-state policies (p. 74):

"The utopian idea of happiness was intimately connected with the place, needs and tasks of women in the "new society." The "woman question" was a fundamental issue in the utopian blueprints of Robert Owen and Charles Fourier, the two most important creators of early nineteenth-century utopias. For example, Fourier thought of sexual love as one of the most important relations among members of his imagined harmony. Living in big, Versailles-like

houses called the Phalangsthere, the inhabitants of his utopia would all have the opportunities of acting, working and being creative ... Children would be taken care of by the "community" and be reared in the utmost freedom, where their talents would be explored and developed. Owen ... also imagined the women of his utopia as free, with access to work, to politics, to love and with freedom from children as well. Children, for both of these thinkers, were a kind of raw material for making the "new man," the smallest unit of the "new society.""

This, again, relates back to demographic planning as envisioned by the Myrdals. The need for the "new man" was associated with the need for demographic planning and the balancing act of child bearing on the macro-social level: on the one hand to keep people from having so many kids that they had to raise them in poverty; on the other hand, see to it that enough children were born to feed the workforce.

Furthermore, demographic planning also involved securing the highest genetic quality of the population, providing them with the highest possible social and economic potentials (p. 205). Government needs this enhanced population stock in order to maximize economic output and minimize the burden that individuals of "less-than-adequate" genetic quality creates for their tax-paying peers.

From Ideology to Legislative Practice

To put their demographic planning in motion, and to achieve the ultimate goal of eliminating economic differences, the Myrdals develop a long list of policy reforms (ch. 6). Some of them are designed to directly impact differences in the standard of living between families with children:

- Move the cost burden of raising a child from the individual family onto taxpayers, coupled with the provision of cash child benefits and paid family leave to minimize and eventually neutralize the extra cost related to raising children;
- Neutralize private compensation differences between by replacing merit-based workforce compensation with a system based on family size;
- Government-provided birth control measures, as well as abortion and sterilization programs (in part to prevent ”feeble-minded citizens” from procreating);

Other reforms have an indirect effect on income differences:

- Destroy the price mechanism in markets for consumer necessities, such as groceries, by means of government-dictated (or "regulated") prices, the purpose of which is to

increase demand and provide consumers with greater margins in their monthly budgets;

- Subsidies and other stimulating measures to radically increase home construction, but only when guided by strict government regulations as to size, configuration, appliance standards, etc.;
- Eliminate market mechanisms such as merit pay and hourly wages in construction, manufacturing and other labor-intensive industries, with the intention of eliminating business cycles;
- Mandatory reductions in the work week, with government-dictated definitions of full time employment.

When the Swedish social-democratic government set out to construct the welfare state in accordance with the principles and policy goals defined by the Myrdals, they embarked on a journey of legislation the end point of which was neither visible nor conceptualized at that time. They accomplished the bulk of their goals within a period of less than 20 years.

Child care was one of their first items. In 1938, only four years after *The Demographic Crisis* was published, a government-commissioned report proposed vast expansion of child-care institutions and the addition of explicit pedagogical goals. They also suggested standardized, mandatory training for staff and full-day care from the age of two. In 1944 the Swedish parliament passed a bill creating national child-care subsidies directly modeled after a proposal by Alva Myrdal. In order to receive the subsidies, starting in 1945 kindergartens had to have teachers educated to national standards.

To further tighten government control over kindergartens, in 1962 the Swedish parliament passed a law nationalizing all pre-school teacher colleges.

Starting about the same time as child-care reforms, the Swedish government began planning the nation's home-construction industry. Based on new laws passed by the national parliament, in the late 1930s Swedish cities formed their own "public purpose" non-profit corporations for home construction and maintenance. The purpose was to build new homes in compliance with the ideological desires of the Social Democrat government. These "public purpose" corporations received very generous funding from the national government, as part of an attempt to standardize working and middle-class living.

Through the mid-1940s the Swedish government essentially socialized the construction industry by means of regulations, financing, zoning and master planning.

From the regulatory side government mandated minimum apartment sizes, initially by capping the number of people who "should" live in an apartment to two per room. Later the regulatory standard was upped to apartments having one more room than there were members of the household. Other regulations were added, and by 1947 Sweden had its first national standardized law for how homes could and could not be constructed, largely in line with the Myrdals' vision of government-planned home construction and housing.

Government also tried to regulate the cost of housing, which should not exceed 20 percent of household income. This was combined with a means-tested housing subsidy and with tax-paid subsidies and taxpayer-guaranteed loans toward the construction of homes in compliance with government-set standards.[3]

There was a broader goal behind the intense regulatory invasion of the home-construction industry. In *The Demographic Crisis* the Myrdals saw business cycles in private-sector economic activity as an obstacle to a steady expansion of the economy. By eliminating or at least reducing the profit motive in home construction the Myrdals thought the industry could be used as a pro-cyclical fiscal-policy instrument.

As a result of heavy government involvement in housing and home construction, the "public purpose" businesses, owned and operated by local governments, soon became big builders, owners and operators of entire subdivisions of apartment homes.[4] Private competitors were confined to niches of the home-construction market and to commercial real estate.

During the same time as child care and housing became instruments of welfare-state advancement, the Swedish health care system underwent a major transformation. In 1948 a parliamentary committee proposed a full-scale single-payer system, toward which Sweden had begun drifting a decade earlier (Palier 2006, p. 15):

"In Sweden, the transition from a health insurance system to a government-run health care system happened step by step, while at the same time government was in a conflict with the country's physicians. The gradual transition into government control took place by means of

[3] Construction companies could build whatever homes they wanted, but the taxpayer-funded subsidies biased the cost structure in favor of the modern apartment buildings that met Social Democratic ideological goals.
[4] The combination of "public purpose" construction companies and government credits proved enormously successful in socializing the bulk of the housing industry. Government loans that financed five percent of all new apartment homes in 1939 provided funding for 100 percent of them in 1942.

a phase-out of privately practicing physicians from government-controlled health care (especially hospitals) and through growing spending and expanded responsibilities for regional governments."

Over the next decade, step-by-step reforms gradually eliminate private compensation of medical practitioners and placed the provision of health care in government hands. By the end of the 1950s it was no longer possible to practice health care on private funding; the bulk of the health care system had been folded in under a single-payer system.

By the end of the 1950s all regular health care was part of the single-payer system; within another decade remaining medical specialties were incorporated as well.

Other reforms that helped build the Swedish welfare state:[5]

- Tax-paid children's dental care (1938);
- Per-child cash benefits to mothers (1948);
- Nationalized, mandatory school curriculum (1955);
- Paid sick leave (1955);
- Universal retirement security (1960).

Other Nordic countries were following suit. Denmark in particular kept up well with Sweden, focusing on income security in the early 1930s and shifting to general, permanent income redistribution in the 1950s. (Denmark also has a single-payer health care system, public kindergartens and several other entitlement programs similar to the Swedish welfare state.)

Not all welfare states are driven by the same ambition as the Scandinavian ones. A notable example is the British welfare state, the foundation of which is the Beveridge Report. While Britain expanded its entitlement programs rapidly after World War II, the goal was not the complete elimination of economic differences, but rather to provide a comprehensive safety net at the bottom of the income ladder. Brown explains (1990, p. 28):

"In 1944 the government published a White Paper setting out its response to the Beveridge Report. It accepted the broad sweep of the Beveridge Plan that is for a social insurance scheme to cover sickness, widowhood, old age and unemployment. Participation would be compulsory

[5] See annual editions of *Svensk Författningssamling* [Swedish Legislative Archives], available in print at Riksarkivet (National Archives) or at Kungliga Biblioteket (Royal National Library).

for the whole working population who would pay flat rate contributions and, in return, could claim flat rate benefits."

Parliament ended up creating an entitlement system that was more generous than what the Beveridge Report had proposed (p. 29). Among the individual programs was Family Allowance, another reform straight out of the Beveridge Report. Resembling the Swedish Child Benefit where a family received a fixed amount of money per child, it was introduced in a limited form in 1945 and expanded to all families regardless of income in 1956.[6]

In fact, some passages of the Beveridge Report could give the impression that its overall ambition was as radical as that of the Scandinavian welfare state:[7]

"The main feature for the Plan for Social Security is a scheme of social insurance against interruption and destruction of earning power and for special expenditure arising at birth, marriage or death. The scheme embodies six fundamental principles: flat rate of ... benefit; flat rate of contribution; unification of administrative responsibility; adequacy of benefit; comprehensiveness; and classification. ... the aim for the Plan for Social Security is to make want under any circumstances unnecessary."

In theory, the last point could be interpreted as an open-ended goal for welfare-state expansion. All that is needed is to include all of a person's cost of living under "want" and the Beveridge Report would *de facto* set the same goal for the British welfare state as the Myrdals set for its Swedish counterpart.

Against this interpretation stands the overall tone and ambition of the Beveridge Report, suggesting a compassionately, socially and economically preservative agenda rather than the radical transformational ideology of the Myrdals.

The Stagnation of an Open-Ended Project

In 1958 Gunnar Myrdal gave the Storr Lecture at Yale University. Reflecting the success of the Scandinavian welfare state at the time, Myrdal reinforced the idea that the welfare state's expansion is an open-ended project. It is driven not only by its own virtue but by an endless demand for state intervention from key constituencies (1958, p. 27):

"The urge for economic equalisation is everywhere present, and it is commonly proclaimed as a principle. Its sphere of operation is not limited to taxation and to redistributional expenditure

[6] Please see: http://www.nationalarchives.gov.uk/cabinetpapers/themes/beveridge-report-child-benefit.htm
[7] Please see: http://www.sochealth.co.uk/national-health-service/public-health-and-wellbeing/beveridge-report/beveridge-summary-plan-social-security/

schemes like those for various forms of social insurance. It enters into, and determines, the scope of all other state intervention. … it then becomes one of the main driving forces behind the general trend towards increasing the volume of state intervention … Generally speaking, the less privileged groups in democratic society, as they become aware of their interests and their political power, will be found to press for even more state intervention in practically all fields."

Myrdal envisions a point when resistance to the welfare state is futile. Universal suffrage, he says, will produce a steady expansion of the welfare state. This force is so strong and so relentless that "conservative and liberal parties will have to become the vehicles for this development, or else disappear from the political scene" (1958, p. 27).

Myrdal's prediction came true. The Swedish welfare state, like its Scandinavian brethren, has become such a natural part of society and the economy that even the conservatives have accepted it. Former chairman of the Swedish conservative party, Gunnar Heckscher, has confirmed this (1984). However, Heckscher makes an interesting observation: the practically universal acceptance of the welfare state was contingent upon a change in its expansion, from radically transformative to a permanent yet static institutional structure (p.46):

"It is futile to ask whether this was "socialism". Such purely semantic questions did not interest the Scandinavian reformers. They were accused of being Socialists by their opponents, but they took no special pride in the name. In fact, as often as not they insisted that their objectives should be acceptable to all sensible and responsible politicians, regardless of ideology. In this regard, they were similar to their British contemporaries, one of whom (Philip Snowden) used to say that he had been more influenced by the Sermon on the Mount than by Karl Marx."

Heckscher's point is partly based on the fact that the Swedish welfare stopped expanding in the early 1960s. Rather than forging into the territory of central planning, the Swedish social democrats shifted gear and spent their political capital completing, rather than expanding, the welfare state they had already constructed. They finalized the incorporation of remaining health-care sectors into the single-payer system, they topped off their socialized housing policy with a ten-year housing construction program, they extended mandatory vacation time (essentially an enforced entitlement program) and reduced the definition of the full-time work week to 40 hours.

The transition from expansion to stagnation of the welfare state was the one event Gunnar Myrdal did not foresee. His vision was instead that the welfare state would be succeeded by an

even higher level of government management of society: central economic planning. As he saw it, the welfare state was sprawling in so many directions that the time would come when it would be natural to coordinate all entitlements and all taxation under the welfare state under one centralized umbrella of planning (1958, ch. 5). While his vision of central economic planning is more of the indicative kind than the teleological, Soviet-style model, it would nevertheless involve invasive elements of disrupting free markets, primarily in the form of the replacement of the free-market price mechanism with weights of needs and centrally managed priorities.[8]

It is not entirely clear why the social democrats in Sweden failed to push the country into the central-planning stage. From a macroeconomic viewpoint it would have seemed easy for welfare-state proponents to maintain its expansion: the Swedish economy grew at 4.6 percent per year through the 1960s, compared to 3.3 percent in the preceding decade.

One theory is that tax increases, which began during the expansion phase of the welfare state from the late 1930s through the late 1950, became so pervasive during the 1960s that it sparked popular resistance to further government intervention (Larson 2006). This is a contestable point since the Swedish economy actually grew more strongly in the 1960s than in the ‘50s, though it was not until the latter half of the ‘60s that government spending and taxation in Sweden passed the 40-percent-of-GDP mark. At that point welfare-state economies generally seem to experience a permanent decline in growth (Larson 2014). This is essentially a delayed macroeconomic effect of the institutional expansion of the welfare state (Sanandaji 2016).

Regardless of the reason why the Swedish welfare state stagnated, its doing so brought it more in line with other welfare states in Europe, primarily the British. Central planning was never a major component of the British welfare state, whose proponents have overwhelmingly shied away from the idea. In fact, there is clear agreement on this point between Beveridge himself and economist Stuart Holland, a former Member of Parliament for Labor and one of Britain’s most influential welfare-state experts.

In fact, in his writings and his political practice Holland carries the legacy from the Beveridge Report with care and commitment (Wickham-Jones 1996). This helped build and preserve political unanimity behind the welfare state. The goal with the British welfare state, to alleviate income differences, was static in nature once a certain level of income redistribution had been

[8] Myrdal was not alone in envisioning central economic planning as the natural highest stage of the welfare state. American economist John Kenneth Galbraith expressed similar ideas. See, e.g., *The New Industrial State*, Houghton Mifflin, Boston, MA 1967.

institutionalized. This led politicians from all walks of the political spectrum to accept it; not even staunchly conservative Lady Thatcher would attempt to reverse the welfare state on a broad front. By the same token, once the Swedish welfare state politically – though not ideologically – abandoned its revolutionary ambitions, its largely static institutional nature from the 1960s and on facilitated its wide acceptance among non-socialist politicians.

Institutional stagnation combined with universal political support makes for a strong case against those who argue that the welfare state be reformed away. That does not mean, though, that the key question of this paper has already been answered.

Is Dismantling the Welfare State Possible?

The welfare state is the product of a decades-long, concerted ideological ambition to fundamentally remake the institutional structure of the Western economies. Even a cursory observation of its history and present state as put forward in this paper strongly suggests that the welfare state is essentially part of the "socio-economic DNA" of the modern Western world.

It is also a fact that the same Western world that has embraced the welfare state is facing tremendous macroeconomic challenges in the form of slow-to-no growth, high, persistent unemployment, suppressed domestic absorption and high taxes. These ailments, which by now are indisputably permanent, constitute a formidable challenge to the redistributive state. Alas, the question: is it at all possible to dismantle it and thereby eliminate all the institutional structures that redistribute 40-50 percent of our economy?[9]

The answer to this question boils down to a dichotomy between two theories of how the welfare state interacts with its macroeconomic environment. These two theories emerged as attempted responses to the fiscal challenges that Europe's welfare states were presented with starting in the 1970s. Those challenges emerged as a result of persistently low GDP growth, stagnant private consumption, perennially high unemployment and unending budget problems. As the trend emerged consistently across Western Europe in the 1980s, tighter public finances sparked a debate among welfare-state scholars about the status and the fate of the welfare state.

Two camps emerged, putting forward two different theories of whether or not the welfare state was responsible for the new era of stagnation.

[9] The question of whether or not dismantling the welfare state is *desirable* has been purposely left out of this discussion.

The exogenous theory

It was a simple matter to ignore macroeconomic performance under the welfare state so long as GDP was growing at healthy rates. However, the slowdown in growth that began during the macroeconomically tumultuous 1970s and prevailed through the 1980s opened the welfare state to performance-based criticism. The growth in the cost of entitlement programs came under scrutiny and political challenge during the Thatcher era. In the late 1980s a Danish center-right government faced serious cost issues related to the nation's welfare state. The government responded with the so called "potato remedy" program, one of the toughest austerity programs imposed on a welfare state to that date.

Yet the existential challenge to the welfare state that could have emerged from the combination of slow growth and high entitlement costs, never came to fruition. Blau (1989) notes that the decline in growth in Western economies in the 1970s and '80s did not put an end to welfare-state growth. Therefore (pp. 26-27):

"As the social costs of a minimalist state have become more apparent in the late 1980s, the conservative view of the welfare state has lost its power, and there are signs we are approaching the threshold of a new conception that calls for increased public responsibility. These signs include the 1987 federal housing bill ... and a greater receptivity to the need for day-care provision."

In other words, the welfare state is exogenous in the sense that its existence and operation does not have any negative macroeconomic influence – or, in other words, that its spending programs have continued to grow despite a stagnant GDP and thereby stagnant tax revenue.

This equilibrium theory is contested. According to Venkataraman (1994), the 1970s and '80s saw a dominating ideological challenge to the welfare state. Blau himself is not completely convinced of his own theory (p. 31):

"The economic slowdown invigorated the conservative critique of the welfare state and weakened the position of many liberals. For these proponents of the ideological consensus, the appearance of fiscal constraints was especially disruptive. Without fiscal constraints in the 1960s, the welfare state grew in steady, measured steps; with fiscal constraints in the 1970s, it seemed to falter."

Nevertheless, if the welfare state is exogenous in Blau's terms it means that it can continue to exist, essentially impervious to its macroeconomic environment, and that its proponents can

declare definitive victory over their critics (to the extent they are still around). While the American welfare state is not subject to this paper, it does provide some evidence toward Blau's viewpoint. Since 2000, the U.S. economy has slowed down markedly, with two sluggish recession recoveries and only a brief period under the second Bush Jr. presidential term with historically normal growth rates. Yet despite that growth slowdown the American welfare state has continued to grow, of which Tanner et al (1995) and Tanner and Hughes (2013) provide compelling evidence. While at least 126 entitlement programs have grown generously during that period of time, average GDP growth has fallen by about one percentage point.

The problem with the view that the welfare state is exogenous to the macroeconomy is that it also has to ignore the need for tax revenue. The pressure of stagnant revenue has not yet brought an end to the expansion of the American welfare state (where instead deficits have become a permanent funding source for the federal government) but Europe has had a painful experience with revenue restrictions.

These revenue restrictions are permanent in nature, presenting European governments with a tough long-term decision that most of them appear to want to shy away from (Larson 2014, p, 4):

"The current crisis suggests, rather sternly, that Europe's political leaders can no longer take for granted that the private sector can pay for the welfare state. Yet it is precisely the ignorance toward this suggestion that has led Europe's political leaders to the conclusion that the current economic crisis is just another recession."

In other words, the budget crisis that characterizes the modern European welfare state is structural in nature but still perceived, and responded to, as a cyclical phenomenon. As a result, Europe is increasingly adopting the American habit of amending tax revenue with deficits in order to maintain welfare-state spending. Although scientific evidence cannot be cited, it is tempting to draw the conclusion that Europe's elected legislators have spent more time and political effort during the Great Recession on securing deficit funding for their welfare states, than they have on trying to structurally realign their welfare states with a lower long-term growth trajectory.

The emphasis on deficits suggests that the prevailing political wisdom in Europe is to preserve the welfare state. This in turn suggests that the view of the welfare state is exogenous, namely that its spending programs and taxes do not harm the economy over the long term.

One would expect the practice of austerity in several European countries since at least 2011 to counter the exogenous theory. In other words, austerity – where higher taxes pay for less generous entitlement programs – would be decisive fiscal evidence that the welfare state is not at all independent of its macroeconomic environment.

Atherton (1989) suggests otherwise, explaining that while the welfare state has stopped expanding, the reason is not fiscal pressure. Instead, it is caused by the universal acceptance of the welfare state in all ideological camps. This has created an "ideological equilibrium", a point where welfare statists and their opponents reach an implicit compromise on the size of the welfare state (p. 178):

"The programmatic welfare state is not terminally ill. Cost-conscious programs that produce perceivably favorable results are still acceptable. The social insurance programs are safe. Public assistance ... will not be discontinued – although the emphasis on work will remain strong not because the ideologues of the Right insist on it, but because it is important to ordinary middle-class and working people. The political middle is not interested in either going back to laissez-faire or toward the governmentally managed substantive equality of the pure socialist state."

Under Atherton's ideological equilibrium the welfare state has no responsibility for the fiscal pressure it is subject to; the welfare state does not negatively affect its macroeconomic environment.

Atherton receives indirect support from Sihvo and Uusitalo (1995) whose empirical evidence suggest that support for the welfare state has nothing to do with ideology, but rises and falls with the business cycle. In growth periods, when incomes rise and unemployment is low, there is strong public support for the welfare state. By contrast, support dwindles in recessions with higher unemployment and stagnant or falling household incomes. Support then returns to its higher level as the economy improves again.

Others offer more speculative support for the exogenous theory. Korpi (2003) blames the fiscal pressure on Europe's welfare states on unspecified "post-industrial changes" to the economy. In a similarly vaguely defined contribution, Hassler et al (2003) propose the third structural explanation. Exogenous technological shocks to the economy benefit educated workers over uneducated workers – in line with Atherton's suggested shift in labor market conditions – whereupon voter support for the welfare state weakens. No explanation is offered to why educated workers would be less supportive of the welfare state than low-skilled workers.

The problem for Korpi is that his key evidence remains speculative. The cause of the fiscal pressure is causally unrelated to the welfare state, as the exogenous theory suggests. However, it would be a remarkable coincidence if, as he suggests, those unrelated macroeconomic, structural changes would all line up to starve the welfare state for revenue.

Hassler et al present no credible hypothesis of how educated workers actually cause the fiscal pressure on the welfare state. That component in their argument is in even more need given Atherton's and Heckscher's observations of an ideological equilibrium on the welfare state.

Furthermore, the ideological-equilibrium argument explains the apparent universal political support for the welfare state, but it does not refute the suggestion that the welfare state itself is responsible for its own fiscal conditions. In other words, the existence of an ideological entente with respect to the welfare state is not evidence that the welfare state can exist independently of its macroeconomic environment.

The endogenous theory

It is by no means illogical for a welfare-state proponent to accept the endogenous theory. Clayton and Pontusson (1998) note that "it is difficult to discuss the welfare state in isolation, as if it were a detachable appendix of the modern state" (p. 92). In a general argument against the exogenous theory, they contradict the observations by Blau from a decade earlier that the welfare state has continued to grow in times of sluggish economic growth (p. 94):

"Though the willingness of citizens to pay taxes obviously varies with the political circumstances, there is surely something to the idea that the overall level of taxation has reached its upper limits in many OECD countries. At the same time the combination of sluggish productivity growth and mass unemployment since the late 1970s has meant that government revenues at a given rate of taxation have grown more slowly than they did in the 1950s and 1960s, and the internationalization of financial markets has constrained the ability of government to engage in long-term deficit spending. Together, these factors have put downward pressure on overall government spending."

The causal relationship from the macroeconomic environment to the welfare state logically implies a causal relationship in the opposite direction. In other words, the welfare state affects its macroeconomic environment and does so in two ways:

- High taxes discourage workforce participation and entrepreneurship, as well as private consumption; GDP growth suffers, shrinking the tax base for the welfare state;
- Entitlements discourage workforce participation by providing recipients with work-free income; GDP growth is reduced, with negative consequences for welfare-state funding.

In a study of the deep Swedish economic crisis of the early 1990s Lindbeck et al (2003) report compelling evidence of welfare-state created disincentives toward productive economic activity. In line with their findings Lindbeck et al propose reforms to enhance incentives toward work and disincentives toward entitlement demand. The goal is to eliminate the fiscal pressure on the welfare state.

The problem is that, consistent with endogenous theory, such reforms do not work in isolation. Unless deficit spending is used to fund part of the welfare state, these reforms will by necessity take the form of austerity. As they do, they start a process of deterioration of entitlements in the welfare state without corresponding tax cuts. This process is sometimes referred to as retrenchment.

The Challenge Ahead

Endogenous theory recognizes a two-way causal relationship between the welfare state and its macroeconomic environment. The recognition is one of causality direction, but not causality content. It is, however, implied in the literature that the difference between exogenous and endogenous theory follows the same line of distinction as the one between the welfare state that benefits its macroeconomic environment and the one that does more harm than good to it.

More to the point, the question of exogeneity vs. endogeneity is one of systemic analysis; once the causal structure is established, the causal pipelines can be filled with activity going in either direction. The welfare state can affect its macroeconomic environment either positively or negatively; by the same token, the macroeconomic environment can affect the welfare state either positively or negatively.

Conventionally, the exogenous theory has come to represent the welfare state as portrayed by Myrdal and other welfare-state proponents: one that has positive effects on its macroeconomic environment but is not affected by it. The endogenous theory, on the other hand, adds the causal back loop from the macroeconomic environment to the welfare state. As conceptually inadequate as this systemic analysis happens to be, it is the analysis that has emerged in the literature – and the one that is conventionally applied in public policy.

Removing the conceptual inadequacy, one question remains that forcefully influences the future fate of the welfare state: is there a causal back loop or not? In other words, is, or is not, the welfare state affected by its macroeconomic environment?

Proponents of the existence of the back loop point to the change in welfare-state expansion that took place in, largely, the 20 years from the early 1960s to the early 1980s. Relentless expansion was gradually replaced by slow spending growth and, later on in the time period, a sense of emerging resource scarcity.

In, respectively, the late 1980s and early 1990s the Danish and Swedish welfare states went through concentrated periods of spending cuts, partly accompanied by tax increases. During the Great Recession the welfare states of Europe's southern rim have undergone similar periods of radical resource reductions.

All of these cases have coincided in time with a decline or slowdown in the growth of tax revenues. In each case, the legislation behind the adjustment of spending has reflected the change in actual and expected revenue growth, clearly evidencing the existence of a back loop from the economy to the welfare state. The more recent examples have in fact accentuated the back loop effect by means of austerity. Essentially, austerity policies have created a recalibration spiral in which taxation and entitlement spending are recalculated to accommodate a decline in revenue growth:

- A recession causes a slowdown or decline in tax revenues and an increase in demand for entitlements;
- There is overwhelming political support for the welfare state; and
- Government enforces a balanced-budget requirement.

As the recession opens and unemployment increases, more citizens come to the welfare state to cash the entitlements they have been promised. Welfare state spending increases. At the same time, declining employment and overall economic activity flattens or even reduces tax revenue. The welfare state runs a budget deficit.

Rising entitlement demand and falling tax revenue are two parts of the macroeconomic environment that negatively affect the welfare state – in other words we have an active back loop.

The combination of higher expenditures and lower revenue drain the welfare state for money. Sustained budget deficits are negative for future macroeconomic activity and portray the welfare state as an excessive fiscal burden.

By recalibrating spending and taxation with reference to changes in the macroeconomic environment, legislators can hope to make the welfare state more affordable – in other words, more suited to fit a changed macroeconomic environment. However, under the endogenous theory the welfare state is both an agent and a reagent: higher taxes and spending cuts in combination drain the rest of the economy for resources that the welfare state had promised to leave there (tax increases) or provide (spending cuts).

Since the beginning of the Great Recession many European welfare-state economies have gone through repeated rounds of recalibration. Including previous austerity experiences from other European countries (Larson 2014, chs. 2 and 5) it is still not possible to conclude that austerity has restored economic activity to where it was before declining revenue led to a recalibration of the welfare state.

Two conclusions can be drawn from this observation:

1. The welfare state is not the cause of the long-term decline in economic activity in Europe and North America; the welfare state needs more time and better calibration in order to fit a new macroeconomic environment.
2. The welfare state is the original cause of the long-term economic decline; its interaction with the rest of the economy is harmful and will lead to further economic stagnation.

The first conclusion aligns itself with the exogenous theory. It leaves the welfare state guilt free, still needing an explanation of the long-term economic decline in Western economies.

The second conclusion accepts the endogenous theory, implying that the dismantling of the welfare state is macroeconomically necessary. Two questions follow from this conclusion, questions that are related to the nature of the welfare state. They need answers before any program can be designed for the dismantling of the welfare state.

The first question is related to the very purpose of the welfare state, namely the philosophical or ideological issue of income redistribution. In both the Scandinavian and the British welfare states the prime directive of the welfare state is to eliminate (Scandinavia) or substantially reduce (Britain) differences in income and consumption between citizens. In order to win the political battle for the dismantling of the welfare state, how do critics of income redistribution intend to win the philosophical and ideological argument?

The second question goes directly to the heart of what the welfare state has accomplished, namely the massive redistribution of income that takes place as a direct result of a structure of entitlement programs. How can the welfare state be dismantled without leaving large numbers

of people with substantially lower net incomes? Worded differently: how can the dismantling of the welfare state be executed in such a way that it generates enough economic growth to replace the incomes that entitlement programs provide today?

Both these questions can be summarized into the very question that titled this paper:

Is life after the welfare state possible?

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Appendix 1

Will be distributed separately at the WINIR conference. For an early version of the data, please see:

Larson, Sven: *Industrial Poverty: Yesterday Sweden, Today Europe, Tomorrow America*; Gower Applied Research; London, UK 2014.